BUMIPUTRA MERCHANT BANKERS BHD.

v.

SUPREME-QBE INSURANCE BHD.

HIGH COURT MALAYA, KUALA LUMPUR
VC GEORGE J
[CIVIL SUIT NO. C23-2813-86]
4 MARCH 1988

CONTRACT: *Agreement in writing - Plaintiffs to give bank guarantees to defendant's clients - Defendant gave counter guarantee to plaintiff.*

COMPANY LAW: *Whether defendant has power to issue letter of indemnity under Companies Act 1965 - Whether defendant has power under its memorandum to issue letter of indemnity - Whether valid under s. 20 of Companies Act 1965 - Whether substantive ultra vires - Whether in the ordinary course of business.*

By an agreement in writing dated 30 July entered into between the parties, the plaintiff agreed to provide bankers guarantees for the defendants clients and that the defendant would issue a counter guarantee in favour of the plaintiff.

The plaintiff would provide guarantees during the period of 30 July 1980 to 31 July 1981, the aggregate value to be within RM2 million at any one time. The period was extended from time to time.

By a letter dated 21 March 1985 the plaintiff wrote to the defendant advising them that they were prepared to issue a guarantee on behalf of one Dirikon Sdn. Bhd. for RM2 million upon the terms as set out in their earlier agreement save that it was limited to comply with tender/ contract requirements.

On 4 April 1985, the defendant resolved to accept this guarantee facilities as extended on 12 April 1985, the defendant requested the plaintiff to issue a bankers' guarantee to Dirikon for RM500,000 and reserving the balance for other customers. This was done by a letter of guarantee dated 31 July 1985. The defendant provided a counter guarantee by issuing a letter of indemnity dated 31 July 1985 in favour of the plaintiff.

Dirikon breached its agreement with its principal and the plaintiff was called upon the guarantee and the plaintiff paid out RM532,245.55. The plaintiff in turn demanded this sum from the defendant.

Plaintiff then moved the Court under O. 33 r. 2 RHC 1980 for 4 issues to be tried as preliminary issues.

The mutual issues were:

(a) whether the defendant has power to issue the letter of indemnity of 31 July 1985 under s. 19(1)(c) Companies Act 1965 and the third schedule.

(b) whether defendant has power under its memorandum of association to issue the letter of indemnity.

(c) whether under s. 20(1) Companies Act 1965, the defendants' act of issuing the letter of indemnity is not valid by reason that they did not have the capacity and power to issue it.

(d) whether by virtue of s. 20(2) Companies Act, the defendant is barred from asserting the matters raised in para. 7, 8 and 9 of its defence.

Held:

[1] The first 3 issues related to issues of substantive *ultra vires* and by virtue of the memorandum of association and the third schedule of the Companies, the defendant had the capacity and power to enter into the letter of indemnity and other Act transactions.

[2] In any event s. 20(1) of the Companies Act, abolishes the absolute effect of the *ultra vires* doctrine.

[3] Section 20(2) of the Companies Act had no application to the facts of the case.

[4] On the totality of evidence, the business of insurance against contingencies of all description or by way or guarantee and guaranteeing contracts of other persons or company, is in the ordinary course of business of the defendant.

[Defendant to pay plaintiff full amount covered by the letter of indemnity.]

Cases referred to:
Re Horsley & Weight Ltd. [1982] 3 All ER 1045
Rolled Steel Products (Holdings) Ltd. v. British Steel Corp [1985] 3 All ER 52

Legislation referred to:
Companies Act 1965, ss. 19(1)(c), 20(1), (2)
Rules of the High Court 1980, O. 33 rr.32, 5

For the plaintiff - T. Thomas and Tunku Alina Raja Muhd, Alias. M/s. Skrine & Co.
For the defendant - G. Sri Ram and R. Lazar; M/s. Shearn Delamore & Co.

JUDGMENT

VC George J:

By an agreement in writing dated 30 July 1980 (the July 1980 agreement) entered into between the plaintiff (the bank) and the defendant (QBE) the bank agreed to provide at the instance of QBE bankers guarantees in favour of clients of QBE. What was envisaged was that from time to time customers of QBE would approach QBE for guarantees. QBE in turn would require the bank to provide the guarantee needed by their clients. It was agreed between the bank and QBE that any guarantee issued by the bank at the instance of QBE would be "counter-guaranteed" by QBE - in other words QBE guaranteed the bank payment of the amount guaranteed by the bank in the event the bank was required to and paid up on the guarantee it had issued. Apart from the consideration of the counter guarantee provided by QBE the bank was also to be paid a commission for issuing each guarantee. The consideration for QBE providing the bank guarantees to its customers was the taking out of a policy of insurance in respect of each such guarantee (and the payment of premium therefor) by the customer concerned, the policy presumably covering the risk covered by the guarantee. It was envisaged that the guarantees sought would vary not only in respect of the type of guarantee (but within the compass of the general heading "To comply with tender/contract requirements") but also in respect of quantum.

By the July 1980 agreement the bank was to provide guarantees for QBE's customers during the period 30 July 1980 to 31 July 1981 the aggregate value whereof to be within RM2 million at any one time. The period of the availability of the facility was extended by agreement between the parties from time to time and on 19 December 1984 the bank informed QBE by a letter of that date that the availability of the facility, still limited to the aggregate amount of RM2 million, was extended up to 30 November 1985.

It was during this extended period that by letter dated 21 March 1985, the bank wrote to QBE, again under the title "Bankers Guarantee Facility of RM2 million" (which was the title used in the initial letter granting the availability of the facility and in all the letter extending the availability of the facility) advising QBE that the bank was prepared to issue a guarantee on behalf of a customer of theirs called Dirikon Sdn. Bhd. (Dirikon) in favour of British American (M) Insurance Bhd. (British American) for RM2 million. By that letter the bank further informed QBE that the terms and conditions for the bank providing the guarantee to QBE's customer was to be on the terms obtaining i.e., as set out in the July 1980 agreement save that the purpose of the facility which previously was limited "to comply with tender/ contract requirements" of QBE's customers was now extended to include "financing requirements of QBE's clients where bankers guarantees are called for."

On 4 April 1985 the "EXCO" of QBE (which from the submission by Counsel I gathered referred to an Executive Committee appointed to represent the Board of QBE) resolved that QBE be given the authority to accept guarantee facilities up to RM2 million "for the purpose of complying with the requirements of tender/contract, performance, advance payment bonds and other credit and financial bonds/guarantees issued by the company..."

On 12 April 1985 QBE required the Bank to issue a guarantee on behalf of their customer Dirikon for RM500,000 (and not RM2 million) and purported to reserve the utilisation of the balance of the agreed facility of RM2 million for other customers of QBE should there be any seeking bank guarantees. Accordingly the bank issued a letter of guarantee dated 31 July 1985 in favour of British American. What was guaranteed was the repayment of a loan that Dirikon had been granted by British American. QBE provided a counter guarantee by issuing a letter of indemnity dated 31 July 1985 in favour of the bank.

Now Clause 3 of the memorandum of association of QBE sets out the objects for which the company was established. *Inter alia* the company was established to carry on various types of insurance "business" in all or any one or more of their respective branches. Specifically mentioned in Clause 3(1) is the business of insurance against contingencies of all description or by way of guarantee or security. Clause 3(4) appears to re-emphasise this by providing as part of the objects "generally to carry on every kind of insurance business whatsoever including all matters of business ... concerned with (*inter alia*) guarantee business ..." Clause 3(19) provides among the other objects for which the company was established the object of guaranteeing "the contracts or obligations of any person or company and to secure any such guarantee by mortgage or charge over any or all of the assets of the company."

Now, between 5 November 1980 and 12 April 1985 there were fourteen transactions that had been sought by QBE within the RM2 million limit and in respect of which the bank had provided guarantees. Twelve of the guarantees were performance guarantees issued to employers of contractors in the building industry. One other was for a customer of QBE called Ronald Quay Sdn. Bhd. in favour of The New Straits Times Bhd. The relevant portions of that letter of guarantee issued by the bank reads:

> As requested by M/s. Ronald Quay Sdn. Bhd. ... we hereby guarantee the sum of RM100,000 ... being Media Accreditation granted by you.
>
> This guarantee is effective from 23 January 1981 to 22 January 1982 and is conditional on a claim thereunder being made within two months from expiry date ...

In the back to back letter of indemnity issued by QBE to the bank in the Ronald Quay Sdn. Bhd. transaction what was guaranteed was described thus:

> In consideration of your bank having at our request agreed to issue a Bankers guarantee ... in favour of The New Straits Times Bhd. guaranteeing the due performance, observance and compliance by Ronald Quay Sdn. Bhd. ... of all covenants undertakings agreements and obligations on the part of the customer to be observed and complied with under 'against all claims damages, losses or demands made in writing by New Straits Times Bhd. in connection of Advertising Bills' ...

Mr. T. Thomas of Counsel for the plaintiffs submitted that this transaction was not a performance guarantee but a guarantee in respect of payment of money. This appears to be so. "Media accreditation" in the context suggests to me that Ronald Quay Sdn. Bhd. are an advertising agency that was recognised as such by the New Straits Times Bhd. and given credit facilities in respect of advertising bills. The guarantee given obviously was in respect of the settlement of those bills.

The one other transaction was the said letter of guarantee dated 31 July 1985 issued by the bank on behalf of QBE's customer Dirikon in favour of British American guaranteeing the repayment of a loan of RM500,000 that British American had granted to Dirikon. This was, as has been seen, covered by a back to back letter of indemnity also dated 31 July 1985 issued by QBE in favour of the Bank.

Dirikon in breach of its agreement with British American failed to repay the loan (and accrued interest) to British American who accordingly called upon the bank to honour its guarantee which the bank did by paying off to British American RM532,245.55. The bank in turn demanded of QBE pursuant to the said letter of indemnity of 31 July 1985 payment of the payments they had made to British American which demand not having been met the instant writ accompanied by a statement of claim was caused to be issued. A statement of defence was filed in respect whereof there was a reply.

After the pleadings were closed the plaintiff moved the Court under O. 33 r. 2 of the RHC for some 6 questions or issues to be tried as preliminary issues. After hearing arguments on the application it was ordered that 4 of the questions or issues be tried as preliminary issues and the trial took place on the 15 and 16 February when judgment was reserved until the 4 March 1988.

The 4 questions or issues were:

1. Whether the defendant (QBE) has, by virtue of s. 19(1)(c) of the Companies Act 1965, read together with the Third Schedule of the Act, power to issue the letter of indemnity which it did on 31 July 1985 (the July 1985 indemnity) in favour of the plaintiff (the Bank).
2. Whether QBE has power under its memorandum of association to issue the July 1985 indemnity.
3. Whether by virtue of s. 20(1) of the Companies Act 1965 QBE's act in issuing the July 1985 indemnity is not valid by reason only that QBE allegedly did not have capacity or power to issue the same.
4. Whether by virtue of s. 20(2) of the Companies Act and in view of the answers to (1), (2) and (3) above, QBE is barred from asserting or relying on the matters raised in paras. 7, 8 and 9 of QBE's defence.

Encik G. Sri Ram leading for the defendant started off by saying that he had misgivings about the disposal of the 4 questions as preliminary issues. He thought that there may be issues of fact to be adjudicated upon and that as such the questions were not suitable for

disposal as per the order. He appeared to be asking me to review the order to have the 4 questions disposed of as preliminary issues. However as things turned out he appeared to think he need not and did not pursue with that suggestion.

The first 3 questions or issues the subject of this preliminary trial clearly deal with what has been described as substantive (as opposed to procedural) *ultra vires*. The first 3 questions in effect deal with the question whether QBE by its memorandum of association or by the provisions of the Third Schedule to the Companies Act had the capacity or power to enter into the Dirikon transaction whereby QBE provided the bank with the letter of indemnity in respect of the Bank guaranteeing the repayment by Dirikon of the loan to it by British American.

Encik Sri Ram candidly conceded that QBE had the capacity and/or power to do so. Indeed the memorandum of association and the Third Schedule make it unarguable that QBE had both the capacity and the power to enter into that and those other 13 transactions whereby they provided their customers with guarantees issued by the Bank. It is also unarguable that QBE had the capacity and power to secure those guarantees by a charge over their own assets, which QBE did by providing the bank with letters of indemnity in respect of each of the guarantees issued by the bank. A company cannot act *ultra vires* if it does or attempts to do something which falls within the ambit of any one of the objects of the company as set out in the memorandum of association. *Re Horsley & Weight Ltd.;* [1982] 3 All ER 1045; *Rolled Steel Products (Holdings) Ltd. v. British Steel Corp.* [1985] 3 All ER 52. In any event by s. 20(1) of the Companies Act no act or purported act of a company shall be invalid by reason only of the fact that the company was without capacity or power to do the act. The section abolishes the absolute effect of the *ultra vires* doctrine.

In the premises the answer to each of the first 3 questions has to be and is in the affirmative.

That left for adjudication the issues posed by the 4th question which has reference to the effect of s. 20(2) of the Companies Act.

Section 20(2) of the Companies Act has the effect of somewhat watering down the sub-section 20(1) abolishment of the doctrine of *ultra vires* by providing that lack of capacity or power may be asserted or relied on but only:

(a) in proceedings against the company by any member of the company or by the holder (or the trustees for the holders) of debentures;

(b) in proceedings by the company or by any member of the company against the officers, present or past, of the company; and

(c) in any petition by the Minister to wind up the company.

In the instant case the proceedings are against QBE brought by the bank. There is no suggestion that the bank is a member of QBE or the holder (or trustee for the holders) of any debenture. The situation that obtains does not fall within any of the exceptions specified in s. 20(1) of the Act. It follows then that the answer to the 4th question has also to be and is in the affirmative.

But that is not the end of the matter in that Encik G. Sri Ram of Counsel for QBE contends by way of submission the existence of what he has described as procedural *ultra vires*. It was contended that the transaction involving Dirikon was one outside the ordinary course of business of QBE and as such pursuant to Article 59(b) of the memorandum of association could not have been embarked upon without a resolution of the company in general meeting.

The relevant portions of Article 59 relied on for the submission are as follows:

> Article 59(b) - The company and the directors shall not be entitled to enter into complete or effect any of the following transactions or things unless a resolution passed by a special majority (as hereinafter defined) of the members of the company at a general meeting has first been obtained.
>
> (i) any contract outside the ordinary course of business;
>
> (ii) ...
>
> (iii) ...
>
> (iv) the making or receiving of loans or the giving of guarantees or security;
>
> (a) other than in the ordinary course of business;
>
> (b) in favour of any shareholder of the company or to a company in which such shareholder holds or is beneficially entitled to 15% of its issued share capital, or voting power.

Encik Thomas concedes that the bank was aware at all relevant times of the contents of the memorandum of association of QBE and confirmed that no resolution as postulated by Article 59 was ever passed in respect of the Dirikon transaction. He however contends that there was no need for such a resolution as in his submission the Dirikon transaction fell squarely within the compass of the ordinary course of business of QBE.

I pause to deal with the contention by Encik Sri Ram that the burden of proving that the Dirikon transaction was within the ordinary course of business of QBE was on the bank. Paragraphs 7 and 8 of the statement of defence show that the assertion that the transaction was not in the ordinary course of business of QBE is made by the defendant QBE and relying on that QBE contends that the transaction is void *ab initio*. In my judgment in the circumstances, the burden of proving that the transaction was not in the ordinary course of business of QBE falls on QBE in that it is trite that he who asserts must prove. There was a suggestion that because these issues are being tried as preliminary issues the burden which otherwise would fall on the defendant shifts to the plaintiff. I am afraid that I have failed to see the logic for any merit in the suggestion.

Now, in granting the order for disposal of the preliminary issues, directions were given for the filing of affidavits. Affidavits have been filed on the basis of which the parties have to be deemed to have rested their case as far as facts are concerned for the Court to adjudicate on the preliminary questions or issues.

I again pause to state that while I may not review my own decisions, in an O. 33 r. 3 situation, if it turns out that the affidavits stating the relevant facts show that there is such a dispute as to the facts that it would not be suitable for those issues of fact to be resolved by affidavit evidence, the Court may put off adjudication thereon until after a full trial of the issues.

In the instant case the affidavits filed do not show any or any significant dispute on the facts. As to the 14 transactions the relevant particulars whereof are before the Court I do not think very much turns on those transactions other than that they all including the Dirikon transaction were intended by both parties to come within the RM2 million facility made available by the bank to QBE for guarantees to be issued to QBE's customers.

The objects for which QBE was established have been examined. It seems to me beyond any doubt that the Dirikon transaction (as do the other 13 transactions) fall squarely within the terms of one or more of the Clauses 3(1), 3(4) and 3(19) of the memorandum of association.

It seems to me in the absence of evidence to the contrary the defendants are entitled to ask the Court to hold that those objects for which the company was established set out the ordinary course of business of the defendants. The burden of proving that they are not, I have already held, is on the defendant and the defendant has not even sought to prove that the Dirikon transaction was outside the ordinary course of the business of QBE. On the totality of the evidence before me I hold that the business of insurance against contingencies of all descriptions or by way of guarantee is in the ordinary course of business of QBE; I also hold that the carrying on of every kind of insurance business connected with *inter alia* guarantee insurance in part of the ordinary business of QBE; I further hold that guaranteeing the contracts of any person or company is part of the ordinary business of QBE and the securing of such guarantees by a charge over any or all of the assets of QBE is part of the ordinary business of QBE. Accordingly I hold that the Dirikon transaction was part of the ordinary business of QBE and accordingly Article 59 has no relevance in respect thereof. There was no need for a resolution of the company in general meeting and accordingly there was no procedural *ultra vires* as suggested by learned Counsel for the defendants or at all.

What is left to be decided is the effect of the disposal of those preliminary issues or questions on the whole action. In my judgment the disposal of those preliminary issues or questions substantially disposes of the cause and renders the trial thereof unnecessary. Accordingly and pursuant to O. 33 r. 5 of the RHC it is my order that the defendant shall pay to the plaintiff the full amount covered by the letter of indemnity in respect of the Dirikon transaction. I adjourn the proceedings for Counsel to work out the actual amount involved and to prepare a draft order for my approval.

Also found at [1988] 2 CLJ 445